82-1236

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1982

No. ____

B.H. MORTON and THOMAS KENT,

Petitioners,

v.

ZIDELL EXPLORATIONS, INC.,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTION PRESENTED FOR REVIEW

Is a "red letter" cause in a marine repair contract, which exculpates a shipyard from all liability for negligence and which is procured under economic duress, unenforceable under this Court's holding in Bisso v. Inland Waterways Corp., 349 U.S. 85 (1965)?

PARTIES TO THE PROCEEDING BELOW

The parties to the proceedings in the United States District Court for the District of Oregon and in the United States Court of Appeals for the Ninth Circuit are listed in the caption to this proceeding.

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Petitioners pray for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals is not yet reported but is to be reported by order of that court dated December 22, 1982, and appears in the Appendix to this petition (1a). The court of appeals' judgment affirms the decision of the United States District Court for the District of Oregon (16a), which is not officially reported.

JURISDICTION

The court of appeals entered its judgment on October 27, 1982. Petitioners did not seek rehearing before the court of appeals. Petitioners invoke the jurisdiction of this Court under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

This appeal involves no significant issues of statutory interpretation or application.

STATEMENT OF THE CASE

Petitioners seek review of a judgment enforcing a "red letter" exculpatory clause in a ship repair contract.

At trial and on appeal, plaintiff-petitioners contended that enforcement of the clause, procured by economic coercion, was barred by this Court's holding in the Bisso trilogy.[1] Notwithstanding these arguments, the court below insulated the defendant shipyard from all liability for causing a fire that nearly destroyed petitioners' fishing vessel.

Bob Morton and Tho Kent are engaged in the marine construction and equipment business in Seattle. Tr. 170-71; 187-90. Morton owns a small used marine equipment business, and Kent works as a marine construction supervisor. In October 1978, as a joint venture, they purchased a 145-foot, steel-hulled tugboat which had been laying idle on the Willamette River near Portland, Oregon, for several years. Tr. 192. They

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[1] Bisso v. Inland Waterways Corp., 349 U.S. 85 (1955); Boston Metals Co. v. S.S. WINDING GULF, 349 U.S. 122 (1955); Dixilyn Drilling Corp. v. Crescent Towing and Salvage Co., 372 U.S. 697 (1963).

intended to convert this tug, renamed the BRISTOL MONARCH, into a fish-processing vessel for use in Bristol Bay, Alaska. Tr. 191.

Petitioners delivered the vessel into the custody of Zidell Explorations, Inc. to do the conversion work at its shipyard on the Willamette River in Portland. Zidell is part of a small conglomerate of major businesses engaged in marine repair and construction. Tr. 373.

Petitioners entered into a verbal agreement with Zidell to do the conversion work on a time and materials basis. Tr. 196. Petitioners obtained long-term financing to fund this work, but under the terms of their agreement with the lending institution, this "take-out" loan commitment would expire unless the conversion work was completed by June 10, 1979. Tr. 198, 201. At no time in reaching their oral time-and-materials agreement did the parties discuss, much less bargain over, any provision under which Zidell could be exculpated from liability for negligence in performing the ship conversion.

During the fall of 1978, Zidell began the process of converting the tugboat into a fish-processing vessel. By January 1979, petitioners had paid Zidell $87,000 but owed an additional $195,484 for work which had been completed. Tr. 202. Zidell refused to continue with the conversion work until arrangements were made to eliminate this debt and to insure partial payments as future work progressed. Tr. 200.

In January 1979, petitioners and Zidell discussed entering into a written, fixed-price contract to replace their verbal, time-and-materials agreement. Tr. 203. On January 22, 1979, Thomas Kent gave Zidell a note for $338,000, secured by a preferred ship mortgage on his tug EXPRESS. Tr. 271. This note and mortgage were given to secure Zidell so that the shipyard would resume the conversion work.

On January 25, 1979, petitioners came to Portland to discuss the conversion work with Zidell management. Tr. 203. At this time petitioners were given a written, fixed-price agreement, prepared by Zidell's house counsel,

which contained the critical "red letter" clause. Tr. 323. That clause, which purported to exempt Zidell from liability of any sort, read as follows:

> (1) Pending delivery of the vessel by second party [Zidell] to first party [petitioners] all risks of loss or damage to the vessel shall be upon the first party and all and any insurance affording coverage for perils for which the same may be exposed pending such delivery, procured or provided by the first party, shall inure to the benefit of first party. Second party shall not, under any circumstances whatsoever, be chargeable with or liable for damages, direct or consequential, sustained by first party by reason of loss of, damage to or delays in delivery of, said vessel.

Under the terms of this written contract, Zidell was to complete the conversion for $425,000, $200,000 of which was to be paid upon execution of the agreement. Ex. 3.

Petitioners, who were not represented by counsel, signed this agreement with the expectation that Zidell, secured by the mortgage on the EXPRESS,

would immediately resume the conversion work, even though they could not immediately pay the $200,000. However, Zidell refused to resume work until March 1979, when petitioners obtained interim financing and paid Zidell the $195,484 owing, plus a $50,000 deposit. Tr. 208, 210-11. Zidell resumed the conversion work on a time-and-materials basis, and petitioners, accordingly, paid Zidell as work was completed, not on the fixed-price basis specified in the written contract. Tr. 215-16.

On May 2, 1979, while the BRISTOL MONARCH was lying at the Zidell dock, a Zidell employee welding on one of her bulkheads ignited combustible material on the opposite side of the bulkhead, causing a fire which nearly destroyed the vessel. Tr. 258, 267.

Zidell's employees admitted that no fire watch had been maintained on the night of the fire. Tr. 164-65; 315-16. This was a violation of Portland's fire and harbor codes. Exs. 21, 22. In addition, fire department officials testified that Zidell's firefighting equipment was inadequate. Zidell's hoses on

the docks had no nozzles on them, and the hose threads were incompatible with the fire department's national standard nozzles. The one hydrant on the premises was blocked by scrap or debris and was inaccessable to the fire department. Tr. 256-57; 262-63.

Petitioners subsequently filed an action in negligence seeking damages of $284,000 to the vessel and other personal property resulting from the fire, and additional damages of $1,200,000 for loss of the use of the vessel in the Alaska fishing season immediately following the intended completion of the conversion work. The jury, answering special interrogatories, found that Zidell's negligence was 96 percent responsible for the fire.[2] The jury further found, however, that under the

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[2] The jury's finding attributing 4 percent contributory negligence to petitioners was apparently based on testimony by a Zidell foreperson that petitioners had locked the door giving access to the interior side of the bulkhead upon which Zidell's employee was welding. Tr. 309-10.

terms of the written contract between the parties, specifically the "red letter" clause, defendant was exculpated from all liability.

Petitioners, who first contested the exculpatory clause's validity in their pretrial submissions, subsequently moved for a judgment N.O.V. on the grounds that the "red letter" clause was unenforceable under this Court's holding in Bisso v. Inland Waterways Corp., 349 U.S. 85 (1955). CR. 32. Specifically, petitioners argued that the clause should not be enforced because enforcement would encourage and sanction systematic negligence, including violations of municipal fire and safety codes, and because the clause was the product of the sort of economic overreaching condemnned in Bisso. The district court, the honorable Edward Leavy, United States Magistrate, rejected these contentions, finding that "there has been no evidence that the policy considerations of Bisso apply to shipyards," and that plaintiffs had shown no economic overreaching or coercion. (21a)

The court of appeals, while recognizing a split between the First and Fifth circuits in applying Bisso to ship storage and repair contracts, affirmed on the basis of Hall-Scott Motor Car Co. v. Universal Insurance Co., 1.2 F.2d 531 (9th Cir.) cert. denied, 314 U.S. 690 (1941), a pre-Bisso holding. The court held that Bisso merely reaffirmed a long line of towage cases predating Hall-Scott, which were distinguished in Hall-Scott, and, accordingly, Bisso did not overrule Hall-Scott sub silentio. (10a). The court of appeals also affirmed the district court's finding that the "red letter" clause was not the product of economic overreaching as not clearly erroneous. Finally, the court emphasized that its holding was "narrow" and that it did not "purport to circumscribe Bisso's continued application to towage cases." (11a)[3]

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[3] The court of appeals' "narrow" language is ambiguous. It is unclear whether the court was stating that its holding did not limit Bisso's application to towage cases only, or that the

REASONS FOR GRANTING THE WRIT

The judgment of the court of appeals is in direct conflict with this Court's holdings in the Bisso trilogy. The courts below ignored the negligence deterrence policies underlying Bisso. Indeed, neither the district court nor the Ninth Circuit addressed petitioners' principal argument that enforcement of the "red letter" clause would encourage and sanction negligence. Enforcement of the exculpatory clause also runs afoul of Bisso's second "overreaching" rationale where, as here, the insulating provision was procured through economic coercion.

The Ninth Circuit's holding conflicts with First Circuit authority, applying Bisso to ship storage exculpatory provisions. See Fireman's Fund

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3 (cont'd) holding did not circumscribe Bisso's application in towage cases. Under the latter reading, the court would be characterizing Bisso as a jurisprudential aberration whose policies and principles could not be transferred to any other context.

American Ins. Co. v. Boston Harbor Marina, Inc., 406 F.2d 917 (1st Cir. 1969); Fireman's Fund American Ins. Co. v. Capt. Fowler's Marina, Inc., 346 F. Supp. 347 (D. Mass. 1971). Courts of appeal in the Fifth and, by incorporation, the Eleventh circuits have enforced "red letter" clauses in ship repair contracts. Todd Shipyards Corp. v. Turbine Service, Inc., 674 F.2d 401 (5th Cir. 1982); Alcoa Steamship Co. v. Charles Ferran and Co., 383 F.2d 46 (5th Cir. 1967), cert. denied, 393 U.S. 836 (1968). In each instance, however, the contract limited the shipyard's potential liability to a certain amount, rather than exempting the shipyard from all liability for negligence. This Court should accept review to resolve these conflicts on an important question of admiralty law.

I

THE DECISIONS BELOW ARE IN DIRECT CONFLICT WITH THIS COURT'S HOLDINGS IN THE BISSO TRILOGY.

This Court in Bisso v. Inland Waterways Corp., 349 U.S. 85 (1955),

defined the standards against which exculpatory provisions in non-pilotage maritime contracts must be tested.[4] The Court held a provision of a towage contract that placed the "sole risk" of the towage on the shipper invalid as a matter of law. This result represented "merely a particular application to the towage business of a general rule long used by the courts and legislatures to prevent enforcement of release-from-negligence contracts in many relationships such as bailors and bailees, employers and employees, public service companies and their customers." 349 U.S. at 9 (footnotes omitted).

Two policies supported this "general rule:"

> (1) To discourage negligence by making wrongdoers pay the damages, and

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[4] Special policies permit exculpation in the pilotage context. Sun Oil Co. v. Dalzell Towing Co., 287 U.S. 91 (1932). As discussed at pages 18-19, infra, the ship conversion work in the present case was more closely analogous to Bisso towage than to Sun Oil pilotage.

> (2) To protect those in need of goods o· services from being overreached by others who have the power to drive hard bargains.

349 U.S. at 91. Justice Douglas expanded on these policies in a cogent concurrence:

> It ought to be against public policy to allow a vessel to contract against her own fault. To allow her to do so begets recklessness, carelessness, and neglect . . . [T]he design is to prevent those who have absolute control of another's property from extorting an agreement that they may neglect all reasonable precautions to preserve it.

349 U.S. at 97, quoting THE OCEANICA, 170 F. 893, 896 (2d Cir. 1909) (Coxe, J., dissenting.) This analysis was reiterated without qualification in Boston Metals Co. v. S.S. WINDING GULF, 349 U.S. 122 (1955), and Dixilyn Drilling Corp. v. Crescent Towing and Salvage Co., 372 U.S. 697 (1963).

Both Bisso policies are implicated in the present case. Both were compromised in the decisions below. Because the "red letter" clause insulated Zidell

from all liability "under any circumstances whatsoever," the contract eliminated deterrence of such socially undesirable conduct as violations of fire and safety codes. Moreover, the exculpatory provision was not the product of arm's-length bargaining between the parties but of precisely the sort of overreaching that Bisso refused to sanction. Zidell did not even suggest a "red letter" clause at the time of the initial repair contract, when petitioners were free to refuse and to go elsewhere. Rather, Zidell imposed exculpatory language after repairs began, when petitioners were indebted, attempting to secure financing, and unable to move the BRISTOL MONARCH due to Zidell's lien claims against the vessel--when any offer Zidell made was an offer petitioners could not refuse.

The court of appeals ignored Bisso's negligence deterrence reasoning. Its holding on the enforceability of the "red letter" clause was based almost exclusively on Hall-Scott Motor Car Co. v. Universal Insurance Co., 122 F.2d 531 (9th Cir.) cert. denied, 314 U.S. 690

(1941), a pre-Bisso decision which made no reference to negligence deterrence. Notwithstanding the Ninth Circuit's silence, the record is an indictment of Zidell's conduct and a vindication of Bisso's negligence deterrence policy. Zidell, liberated from liability, acted in systematic disregard of fire and safety codes.

It is undisputed that Zidell's negligence caused the fire aboard the BRISTOL MONARCH. But this was not a momentary bit of carelessness.

Zidell failed to maintain a fire watch as required by Portland's city fire code and harbor code. Zidell failed to instruct its employees concerning fire regulations and safety procedures. It failed to supervise properly welding operations onboard ship, failed to inspect the ship before welding, and failed to remove flammable material from the inside of the bulkhead before welding on its exterior. After the fire started, Zidell's firefighting equipment was completely inadequate. The hoses along the docks did not have nozzles on them, nor were the hose

threads compatible with the fire department's national standard threads. The one hydrant on the premises was blocked by scrap or debris and was inaccessible to the fire department. In short, Zidell could not have acted in more total disregard of relevant safety standards and procedures had it consciously set out to do so.

The circumstances militating against exculpation of negligence in this case are more closely analogous to those in the towage context than to those in pilotage, where the Court has permitted exculpation. Sun Oil Co. v. Dalzell Towing Co., 287 U.S. 291 (1932). In Bisso, Justice Black carefully distinguished Sun Oil:

> A pilotage clause exempts for the negligence of pilots only; a towage clause exempts from all negligence of all towage employees. Pilots hold a unique position in the maritime world and have been regulated extensively both by the States and Federal government. Some state law make them public officers, chiefly responsible to the State, not to any private employer. Under law and custom they have an independence wholly incompatible

> with the general obligations of obedience normally owed by an employee to his employer . . . . As a rule no employer, no person, can tell them how to perform their pilotage duties. When the law does not prescribe their duties, pilots are usually free to act on their own best judgment while engaged in piloting a vessel. Because of these differences between pilots and towage employees generally, contracts stipulating against a pilot's negligence cannot be likened to contracts stipulating against towers' negligence. It is one thing to permit a company to exempt itself from liability for the negligence of a licensed pilot navigating another company's vessel on that vessel's own power. That was the Sun Oil case. It is quite a different thing, however, to permit a towing company to exempt itself by contract from all liability for its own employees' negligent towage of a vessel.

349 U.S. at 93-94 (footnotes omitted).

In this case, the defendant shipyard was not subject to strict regulation and licensing which minimized the potential for negligence and rendered further deterrence nugatory. Nor were

the Zidell employees, whose negligence caused the fire, independent actors whose negligence could not be attributed to, nor effectively controlled by, their employer. They were, rather, closely akin to the tug crew-employees in Bisso. In a related sense, Zidell acted more as the tug of a "dead tow" than the pilot of a "live ship" operating under its own power. Zidell functioned much as a bailee. It controlled the BRISTOL MONARCH; the impetus for the vessel's destruction was exclusively Zidell's.

Nonenforcement of the "red letter" clause, consistent with Bisso, would promote optimal deterrence of negligence by placing the costs of accidents on Zidell, "the party best situated to adopt preventative measures and thereby to reduce the likelihood of injury." Italia Societa v. Oregon Stevedoring Co., 376 U.S. 315, 324 (1964). Zidell was in a superior position to compare accident costs and avoidance costs. See G. Calabresi, The Costs of Accidents: A Legal and Economic Analysis (1970); Calabresi, "Optimal Deterrence and Accidents: To Fleming James, Jr.,"

84 Yale L.J. 656 (1975). With its vast history of ship repairs and its familiarity with its own facilities and operations, Zidell could assess the risks of accidents and the costs of various preventative measures with far more precision and sophistication than petitioners, who had little experience with ship repairs.

Zidell's business is ship repair and conversion. It has far greater knowledge of fire safety regulations and practices than the shipowners with whom it contracts. With such knowledge comes commensurate appreciation of the costs of care and the risks of neglect. And Zidell wields and controls the implements of fire. Zidell can weigh the consequences of particular practices much more accurately than can ship owners.

As the better cost avoider, the burden of accident avoidance should fall on Zidell. It must not be permitted--and, under Bisso, is not permitted--to shift this burden, to act without the

limits of liability, through a "red letter" clause.

The court of appeals, forsaking consideration of negligence deterrence, based its holdings solely on Bisso's economic overreaching rationale. Specifically, the Ninth Circuit affirmed the district court's finding that because Zidell was not "the only game in town," the exculpatory language could not have been the product of economic coercion. This analysis misconstrues this Court's holdings, for it presumes that an exculpated defendant must enjoy a virtual monopoly before Bisso's "overreaching" policy is triggered.

Nothing in the Bisso trilogy characterizes the existence of a monopoly as the sine qua non for nonenforcement of an exculpatory clause. Rather, the Court in Bisso, while recognizing "monopolistic compulsions," identified negligence deterrence and protection against overreaching by those "who have the power to drive hard bargains," as independent policies, the "two main reasons" for nonenforcement of exculpatory provisions. 349 U.S. at 91. Either of these

policies alone, or some sliding-scale combination of the two, can compel non-enforcement of a "red letter" clause.

This reading of Bisso was confirmed in Dixilyn Drilling Corp. v. Crescent Towing & Salvage Co., 372 U.S. 697 (1963). In Crescent Towing & Salvage Co. v. Dixilyn Drilling Corp., 303 F.2d 237 (1962), the Fifth Circuit, finding no evidence of overreaching, emphasized that "Crescent had competition on movements of this kind from three harbor towing companies in New Orleans and from others in Mobile and in the Galveston-Houston area." 303 F.2d at 246. This Court, reversing the court of appeals' affirmance of the exculpatory clause, neither disputed nor rejected this essential finding.

Zidell did not enjoy a monopoly of ship repair or conversion in the Portland area. But it was a functional monopolist vis-a-vis petitioners at the time it extracted the "red letter" clause. Petitioners' only choice was submission. That is the essence of Bisso overreaching.

Zidell imposed the exculpatory clause not at the time the parties freely entered into their initial oral time-and-materials agreement, but in January 1979, three months later, after construction had begun. In January, petitioners owed Zidell $196,000 and had been unable to secure interim financing. Petitioners' long-term financier had set a June commitment deadline for completing conversion. Petitioners could not take the vessel to a different shipyard because Zidell would have enforced maritime and possessory liens and would not have released the vessel without payment. Zidell gave petitioners the choice of accepting the contract, including the exculpatory clause, or losing their investment in the vessel itself.

The court of appeals concluded that petitioners were not overreached because, if they felt victimized by the exculpatory clause, they could have taken the vessel elsewhere in March, when they paid their outstanding balance. (10a-11a). This is incorrect. Had petitioners removed the partially converted ship

in March, they would have been subject to suit for breach of the parties' written fixed-price conversion contract, with consequential damages, including lost profits.

Again, it must be emphasized, consistent with Bisso's "hard bargaining" concern, that Zidell did not bargain for an exculpatory clause initially, at the time petitioners were free to go elsewhere. It was doubtless because of this freedom that Zidell did not even mention any sort of "red letter" clause in October 1978. Only after substantial work had been completed and petitioners were unable to move the BRISTOL MONARCH --only when Zidell was "the only game in town" open to petitioners--did Zidell impose its terms.

The court of appeals also suggested that petitioners, by failing to meet payment schedules, had placed themselves at an economic disadvantage and are in no position to complain. This misses the mark, for there was no connection between Zidell's insecurity and its imposition of the "red letter" clause.

Creditors can require additional security because of changing circumstances over the terms of a contract; Zidell's demands for payment and for a preferred ship mortgage on the tug EXPRESS were acceptable responses to concerns about petitioners' financial condition. But the imposition of the "red letter" clause was extraneous to these concerns.

The court of appeals misconstrued Bisso's "overreaching" policy and did not address its negligence deterrence policy. Because its decision contradicted holdings of this Court, the writ should issue.

II
THE NINTH CIRCUIT'S DECISION IS IN CONFLICT WITH DECISIONS OF OTHER COURTS OF APPEAL ON THE SAME MATTER

The Ninth Circuit's holding, based on its pre-Bisso decision in Hall-Scott Motor Car Co. v. Universal Insurance Co., supra, conflicts with First Circuit authority applying Bisso to ship storage contracts. See Fireman's Fund American Ins. Co. v. Boston Harbor Marine, Inc., 406 F.2d 917 (1st Cir. 1969); Fireman's Fund American Ins. Co. v. Captain

Fowler's Marina, Inc., 346 F. Supp. 347 (D. Mass. 1971). The Fifth Circuit has enforced provisions limiting shipyards' liability, rather than exempting them from all liability or negligence. See Todd Shipyards Corp. v. Turbine Service, Inc., 674 F.2d 401 (5th Cir. 1982); Alcoa Steamship Co. v. Charles Ferran & Co., 383 F.2d 486 (5th Cir. 1967), cert. denied, 393 U.S. 836 (1968). The Eleventh Circuit, by incorporation, also subscribes to this approach.

In Fireman's Fund American Ins. Co. v. Boston Harbor Marina, Inc., supra, the court sua sponte analyzed Bisso's application to a ship storage contract insulating the storage facility from liability for fire losses caused by its negligence. The court held that Bisso did govern the contract's validity but remanded for development of a fuller record on negligence deterrence and relative bargaining power issues. 406 F.2d at 920-21. Accord, Fireman's Fund American Ins. Co. v. Captain Fowler's Marina, Inc., supra (plaintiff's yacht destroyed under circumstances closely analogous to those presented here;

exculpatory clause in storage contract invalid under both Massachusetts bailment law and Bisso admiralty principles).

The Fifth Circuit has never explicitly considered the validity of a "red letter" clause exempting a shipyard from all liability for negligence. It has, however, twice enforced contractual limitations of liability in ship repair contracts. In Alcoa Steamship Co. v. Charles Ferran and Co., supra, the court found a clause that limited the defendant shipyard's liability to the first $300,000 in damages valid under Bisso. "Potential liability for $300,000 should deter negligence." 383 F.2d at 55. Similarly, in Todd Shipyards Corp. v. Turbine Service, Inc., supra, the court enforced another $300,000 limitation of liability provision. 674 F.2d at 410-11. Cf. Canarctic Shipping Co. v. Great Lakes Towing Co., 670 F.2d 61, 63 (6th Cir. 1982) (distinguishing exemption "immunizing" defendant in towage context, from limitation of liability "which does not induce or encourage negligence"). The Eleventh Circuit,

through its adoption of Fifth Circuit law, adheres to these holdings.

Four courts of appeals have split on the implications of Bisso, a significant and recurrent issue in admiralty law. The Court must grant this petition to resolve these conflicts.

CONCLUSION

For all the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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